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TAGS: EFIN ECON PGOV VE
SUBJECT: FINANCE MINISTRY OFFICIAL MAKES SALES PITCH

Classified By: Economic Counselor Richard M. Sanders. Reasons 1.4(b) a nd (d).

Summary

¶1. (C) In a March 21 meeting with econcouns, Rudolfo Romer, the head of the Finance Ministry's National Public Credit Office (and thus chief liaison with the international investment community), expressed satisfaction with a recently concluded billion euro bond issue. He asserted that the GOV policies, including the creation of off-budget trusts for infrastructure and of massive "missions" to meet health, education, and employment needs, were in fact "rational administration" of the oil bonanza. Central Bank independence was being respected; now there was just "better coordination." The GOV's decision to buy USD 500 million in new Argentine bonds was, he claimed, quite justifiable on economic rather than political grounds. Much of Romer's presentation was unconvincing, but investors, viewing Venezuela through the prism of high oil prices, seem inclined to keep buying GOV securities, for now. End summary.

Financing Strategy) Look for Opportunities

¶2. (C) Rudolfo Romer, head of the Finance Ministry's National Public Credit Office, led off a meeting with econcouns on March 21 by noting his satisfaction with the 1 billion euros (USD 1.3 billion) debt issue the Finance Ministry had concluded on March 7. This had been the first time since 2001 that the GOV had gone to Europe for financing, and was proof of market interest in the "new Venezuela." The issue covered a significant slice of the USD 4 billion which the GOV needs to raise in 2005. How much would be borrowed locally and how much in international markets was entirely a matter of which presented better opportunities. (He admitted to some concern about a likely increase in U.S. interest rates and its impact on emerging market debt as a whole.) He praised previous Finance Minister Tobias Nobrega and his team for having successfully issued instruments to push back large amounts of debt which had been coming due in 2003 and 2004. There would not now be an important spike in immediate obligations until 2008. New financing was thus aimed at meeting the current gap between spending and revenue. While previous debt issues had been quite complex (with mixtures of dollar and bolivar-denominated debt, the latter convertible at preferential rates), for the recent issue, the GOV went with a "plain vanilla" approach -- a 7 pct interest rate over 10 years on a straightforward euro-denominated instrument, so as not to scare investors who were unfamiliar with Venezuela.

Spending Plans Under Control

¶3. (C) The GOV, Romer asserted, was looking to "administer high oil prices with rationality." He noted that the GOV's budget had prudently assigned a price of USD 23 per barrel for oil. (The Venezuelan basket of crudes now trades above USD 42 per barrel.) When pressed as to whether this low price estimate was in fact necessary to make up for oil production well below the official claim of 3.1 million barrels, Romer declined to engage, saying "I am not an oil expert. I leave that to the Ministry of Energy." He suggested that the GOV's decision to leave USD 2 billion in earnings from state oil corporation PDVSA in separate off-budget trusts, administered by the state Bank for Economic and Social Development (BANDES), was in fact an indication of economic discipline, making sure that the money was spent on long-term infrastructure and human capital projects than on regular spending on salaries and operations.

Argentina Deal -- Economics or Politics

¶4. (C) Econcouns asked how President Hugo Chavez's

announcement that the GOV would now buy USD 500 million in Argentine bonds would be implemented (and how it made sense if the GOV itself was raising new money for its own needs at the same time). Romer responded that the bonds would be purchased by the BANDES, which has large state deposits. He suggested that BANDES might resell some of the debt on the open market. In any event, he added that these were new post-default Argentine bonds which offered good returns and which international investors generally were finding attractive. He denied that the decision had been imposed by Chavez for political reasons. Rather, BANDES management had been interested in the purchase, and had suggested to Chavez that he could announce it publicly. (Comment: This stretches credulity. Whatever the merits of the new Argentine bonds as an investment, tying up this large a sum in them seems like an imprudent decision, to say the least. End comment.)

Central Bank -- Just Good Coordination

¶5. (C) Romer resisted the suggestion that the naming of Chavez loyalist Gaston Parra as head of the Central Bank and the Bank's earlier agreement to transfer to the GOV 3.2 trillion bolivars (USD 1.48 billion) created as a result of devaluation marked a definitive end to the Bank's independence, raising the risk of inflation. He dismissed the issue of how much in foreign currency earnings should be transferred as one of methods of calculation. He saw Parra's selection, which enjoyed ample support within the (majority pro-Chavez) National Assembly, and the naming of new board members as current members' terms expire, as heralding greater "coordination," but he insisted that such coordination "flows in both directions." The GOV, he went on, was sensitive to Central Bank concerns regarding the need to keep inflation on a downward path, and cited inflation in 2004 (19.2 pct, coming in below the 20 pct which the GOV had forecast) as proof of its commitment.

Spending on Missions Will Pay for Itself

¶6. (C) Romer spoke enthusiastically of the GOV's aggressive spending on social welfare "missions." He noted the "collapse" in health and educational systems in the pre-Chavez era, stressing that there was no way that long-term economic growth could be achieved without paying attention to needs in these sectors. The use of ad hoc structures, as opposed to ministries, had been necessary because they were "more agile," but the challenge was now to institutionalize them. He cited GOV statistics on decreased mortality rates as proof of success. When asked if the missions, and the expectations that they will continue indefinitely, were creating enormous financial obligations that would be impossible to sustain, Romer responded that "in a country this poor you cannot use purely fiscal arguments." As for the disequilibria that these spending commitments may create, "you have worse problems in the U.S."

Comment: The Greater Fool Theory in Action

¶7. (C) While Romer, who had previously worked for Finance Minister Nelson Merentes when the latter was in charge of BANDES, was superficially plausible, his assertions, whether they be on the independence of the Central Bank or the GOV's commitment to fiscal discipline while keeping billions in PDVSA earnings off-budget, are lacking in substance. Nonetheless, markets appear to like Venezuelan debt. The combination of relatively high rates, caused in large measure by persistent noise about the political environment and the quality of economic decision-making, and the confidence that in the end, oil revenue provides a guarantee of repayment, makes them irresistible for now. Of course, as one visiting U.S. investment banker told us, those buying Venezuelan debt have a trader's mentality, and do not expect to hold it for long periods. Venezuela thus benefits from the "greater fool" theory (a chestnut of market analysis, under which an investor buys questionable securities not with regard to their quality but with the hope of quickly selling them off

to another investor -- the greater fool -- who is also hoping to flip them). Should oil prices slide (admittedly this could be a long way off), whoever is holding Venezuelan securities, may indeed look foolish. The GOV, which wants to keep its spending machine at full tilt through the December

2006 Presidential elections, however, may look quite smart,
if also quite cynical.
Brownfield

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